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Refining the Itemized Deduction for Home Property Tax Payments

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I. INTRODUCTION

By enacting a $1 million debt limit for deductible home mortgage interest in 1987,[1] Congress opened the way for a fresh inquiry into the home property tax deduction. Adoption of that debt limit reflects a major change in policy—a re-evaluation of the benefits and costs of subsidies to luxury housing.

At first glance a $1 million limit seems ridiculously high if the debt ceiling reflects a decision to stop subsidizing luxury housing. The debt ceiling, however, does not contain an inflation adjustment provision. Because such provisions are common in the Internal Revenue Code, the absence here must be by conscious design. Political pressures no doubt required a debt ceiling to debut at a token level and slowly grow by inflation into a meaningful limit. Already, inflation has achieved a significant step that Congress apparently wanted but lacked the courage to take.[2]

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1. Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10,102, 101 Stat. 1330-384, 1330-385 (amending § 163(h) of the Internal Revenue Code [hereinafter Code]).

2. To illustrate, a $1 million ceiling in August 1990 is equivalent to an $855,000 ceiling in August 1987, the effective date of the provision, in real terms. If the increase in housing costs

This change in policy calls for a re-evaluation of the property tax deduction. In general, mortgage interest and property tax on a principal residence[3] are economically analogous costs of purchasing a home. Neither is appropriately deductible as a matter of defining net income, but both are deductible as concessions based on nontax policy. If deduction of home mortgage interest is to be limited, consistency requires that deduction of home property tax also be limited.[4]

This Article develops a proposal to limit the federal income tax deduction for home property tax. Under the proposal, no more than $5000 of property tax on a principal residence will be deductible, and no deduction will be allowed to any taxpayer with adjusted gross income (AGI) greater than $250,000. The Article determines that a theoretically pure definition of taxable income would not allow any deduction for home property tax payments, but that certain social policies are furthered by the deduction. Analysis of those social policies reveals that they can be fulfilled by a limited deduction, thereby reducing the cost and increasing the cost efficiency of promoting such policies.

II. Home Property Tax in a Theoretical Definition of Income

Among authors who address a theoretical definition of income, a strong consensus holds that rental value of an owner-occupied home should be included in the owner's gross income.[5] If gross income from rental value is imputed to a homeowner, deductions for home property tax, home mortgage interest, repairs, and depreciation are considered appropriate as expenses of earning the imputed income. As a result, only net rental value is taxed, as with an arm's-length landlord. But imputed income from owner-occupied housing never has been included within the reach of our federal income tax.[6] If gross rental value is not

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during the above period continues, by August 1996, a $1 million limit will be equivalent to a $626,000 ceiling in August 1987. These figures are based on increases in home ownership costs, rather than general inflation. Council of Economic Advisers for the Joint Economic Comm., 101st Cong., 2d Sess., Economic Indicators 23 (Sept. 1988 & Oct. 1990).

3. Hereinafter, for convenience, these will be referred to respectively as "home mortgage interest" and "home property tax."

4. By analogy, the 1986 repeal of deductions for sales tax and for nonhome, nonbusiness interest argues persuasively that nonhome, nonbusiness property tax also should be nondeductible. This argument applies to both real property tax, such as that on a vacation home, and personal property tax. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 134(a)(1), 100 Stat. 2085, 2116 (sales tax), § 511(b), 100 Stat. 2085, 2246 (nonhome, nonbusiness interest) [hereinafter 1986 Tax Act]. In this Article I discuss only home property tax issues, although I do note that nonhome, nonbusiness property tax deductions should be eliminated for reasons similar to those developed herein.

5. *See, e.g.*, H. Simons, Personal Income Taxation: The Definition of Income As a Problem of Fiscal Policy 112-22 (1938); W. Vickrey, Agenda for Progressive Taxation 18-24 (1947).

6. The Wisconsin state income tax included such income for a few years early in this cen-

imputed to an owner, definitional justification for deducting home property tax is lost.

David Bradford's book, *Blueprints for Basic Tax Reform*,[7] begins its discussion of a deduction for nonbusiness property tax with the issue of imputed income from rental value of nonbusiness property. While accepting the economic reality of such income, *Blueprints* advises against including it in gross income for tax purposes "[p]rimarily for the sake of simplification."[8] A property tax deduction, however, would cause a further understatement of income. Because such a deduction would discriminate against tenants, the *Blueprints'* model tax allows no deduction for property taxes on owner-occupied homes.[9]

The best known American author on income definition, Henry Simons, unfortunately did not address specifically a nonbusiness property tax deduction in his treatise on the definition of income.[10] Henry Aaron interprets Simons's definition of income to be before other taxes are imposed, that is, without deduction for nonbusiness tax.[11] Aaron includes the home property tax deduction in his *Inventory of Existing Tax Incentives*.[12] Richard Goode discusses Simons's definition and determines that "[l]iterally, the . . . definition applies to income net of direct personal taxes; however, it has generally been interpreted to mean income before personal taxes, or perhaps more accurately no account has been taken of the existence of personal taxes."[13]

William Vickrey, writing ten years after Simons, opposed a nonbusiness property tax deduction on theoretical grounds. In support of his assertion that no deduction be allowed, Vickrey states that "[e]limination of this unwarranted deduction for taxes will considerably reduce the disparity between the tax burdens of homeowners and tenants, and will introduce no new disparities."[14] He further argues that eliminating the property tax deduction is theoretically more sound than eliminating the home mortgage interest deduction, another often-criticized itemized deduction.[15]

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tury. Haig, *The Concept of Income—Economic and Legal Aspects*, in THE FEDERAL INCOME TAX 14-15 (R. Haig ed. 1921). England taxed it until 1963. Hellmuth, *Homeowner Preferences*, in COMPREHENSIVE INCOME TAXATION 170 (J. Pechman ed. 1977).

7. D. BRADFORD, BLUEPRINTS FOR BASIC TAX REFORM (2d ed. 1984).

8. *Id.* at 78.

9. *Id.* at 79.

10. *See generally* H. SIMONS, *supra* note 5.

11. *See* Aaron, *What Is a Comprehensive Tax Base Anyway?*, 22 NAT'L TAX J. 543, 543-45 (1969).

12. Aaron, *Inventory of Existing Tax Incentives—Federal*, in TAX INCENTIVES 42-44 (1971).

13. Goode, *The Economic Definition of Income*, in COMPREHENSIVE INCOME TAXATION, *supra* note 6, at 17 (footnote omitted).

14. W. VICKREY, *supra* note 5, at 22.

15. Vickrey states:

A contrary concern often mentioned in support of the deduction of state and local taxes is that the absence of a deduction could produce a combined tax rate in excess of one hundred percent.[16] This concern first arose in connection with state and local income taxes, in situations in which two or more authorities are using one tax base. When moved to a property tax discussion, however, this concern loses much of its coherence because the two governments are using different and unrelated tax bases. Furthermore, as reported in a tax reform proposal of the United States Department of Treasury[17] in 1984 (*Treasury I*), "Given the present levels of tax rates, such an argument is no longer relevant."[18]

In a 1985 article Brookes Billman and Noël Cunningham criticize a proposal, found in both *Treasury I* and its subsequent modification (*Treasury II*), to eliminate all deductions for nonbusiness state and local taxes.[19] Their comments are directed primarily to *Treasury II*, but are applicable to *Treasury I* as well. They begin from the Haig-Simons definition of income as consumption plus net saving.[20] Because statutory gross income is calculated from money income plus certain in-kind receipts, rather than by direct counting of consumption and saving transactions, expenditures that are neither consumption nor saving must be deducted from statutory gross income to produce a taxable income figure that conforms to the Haig-Simons definition.

Certainly state and local tax payments are not savings. To characterize a tax payment as consumption, the simplest approach is to conclude that a taxpayer receives government services equal in value to the tax paid. If so, the tax payment can be seen as a forced purchase of

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With interest on home mortgages the case is not quite so clear cut. While eliminating the deduction of such explicit interest without taxing the imputed interest on equities would reduce the disparity between the tenant and the homeowner with a thin equity, it will not reduce the disparity between the tenant and the owner of an unencumbered home, and it will actually introduce new disparities among homeowners having differing equities in their residences.

Id. at 22-23.

16. *See* Billman & Cunningham, *Nonbusiness State and Local Taxes: The Case for Deductibility*, 28 TAX NOTES 1107, 1116 (1985).

17. *See* OFFICE OF THE SECRETARY OF THE TREASURY, TAX REFORM FOR FAIRNESS, SIMPLICITY, AND ECONOMIC GROWTH: THE TREASURY DEP'T REPORT TO THE PRESIDENT (1984) [hereinafter TREASURY I].

18. *Id.* vol. 1, at 78. *Treasury I* is a thoughtful and valuable analysis by tax policy professionals at the Treasury Department concerning United States tax law as it was and as it could be. President Reagan's tax proposal to Congress embodied a later version of *Treasury I*, modified by political professionals to suit the political agenda and realities of that era. *See* THE PRESIDENT'S TAX PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH, AND SIMPLICITY (1985) [hereinafter TREASURY II].

19. *See* Billman & Cunningham, *supra* note 16, at 1107; *see also* TREASURY I, *supra* note 17, at 78-81; TREASURY II, *supra* note 18, at 62-69.

20. *See* H. SIMONS, *supra* note 5, at 50; Haig, *supra* note 6, at 5-6. As used here, saving includes both saving and investment, as those terms are defined in a narrow, technical sense.

services from state and local governments for personal consumption. Many people, however, pay more in state and local taxes than they receive in state and local benefits. The excess of payment over benefits received cannot be characterized as a consumptive purchase of services.

Unfortunately, in their analysis of whether state and local tax payments represent consumption, Billman and Cunningham pursue only this method of characterization. Applying the Haig-Simons definition to their analysis, they conclude that the portion of tax paid that is equal to the value of benefits received represents consumption and, therefore, income. The excess of state and local taxes paid over benefits received, however, is not consumption and, therefore, not income and must be deducted.[21] Rather than construct a partial deduction mechanism that would allow deduction only of the amount (or the estimated amount) of this excess payment, Billman and Cunningham posit "no deduction" and "full deduction" as the two available solutions.[22] Faced with these options, they choose the latter.[23]

The first flaw in the Billman and Cunningham approach is their uncritical adoption of the failure of *Treasury II* to differentiate between different types of state and local taxes.[24] The second and more significant flaw is their view that the only possible consumptive characterization of state and local taxes is as a forced purchase of government services.[25]

State and local income taxes should be considered separate from property tax.[26] Separation allows for inquiry into the taxpayer's actions or behavior that produced a tax obligation. An income tax, then, can be seen as a tax on, and therefore a cost of, earning income. Analogy to a business expense is so strong that an economically sound definition of net income, rather than nontax social policy reasons, requires a deduction for state and local income taxes.[27] Sound theory would make it a

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21. *See* Billman & Cunningham, *supra* note 16, at 1113.

22. *Id.* Billman and Cunningham mention John Due's partial deduction idea, *id.* at 1113 n.23, but Due proposes only a partial deduction of state and local income taxes (above a 2% AGI floor), with no deduction for sales tax and full deduction for property tax. *See* Due, *Personal Deductions*, in COMPREHENSIVE INCOME TAXATION, *supra* note 6, at 37, 51-52. For a proposal of a nondeductible dollar amount floor under combined state and local income, sales, and property taxes, see McCombs, *A New Federal Tax Treatment of State and Local Taxes*, 19 PAC. L.J. 747 (1988).

23. Billman & Cunningham, *supra* note 16, at 1113-14.

24. *Id.* at 1111-12.

25. *Id.*

26. Sales tax was deductible in 1985, at the time of the Billman and Cunningham article, and they included it in their discussion of tax types. After the 1986 Tax Act, sales tax is not deductible so it is not addressed here. *See* 1986 Tax Act, *supra* note 4, § 134(a)(1), 100 Stat. 2085, 2116. But if it still were deductible, it would be subject to my discussion of property tax for this purpose.

27. *See* Turnier, *Evaluating Personal Deductions in an Income Tax*, 66 CORNELL L. REV.

deduction in calculating AGI rather than an itemized deduction. A property tax on one's home, however, is a tax on, and therefore a cost of, consumption.[28]

Given that characterization, an inquiry into whether a homeowner receives government services equal to property tax paid is unnecessary.[29] Property tax is an integral part of the cost of owning a home, and it is not fundamentally different from the cost of mowing the lawn, which is not deductible. Further, it is unnecessary to inquire whether tax payment was involuntary in the sense that the homeowner voted against the tax, in the less direct sense that some minimum level of housing is a functional necessity, or in the specious sense proposed by *Treasury I* that a taxpayer could move to a place with lower taxes.[30] Many involuntary consumption expenditures are not deductible.[31] In some cities, lawn mowing is mandated by an aesthetics ordinance, yet its cost does not thereby become deductible. The Haig-Simons definition of income makes no distinction based on voluntariness. Consumption, such as home property taxes, and savings constitute income and are not deductible from money income. The costs of producing income,

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262, 267-68 (1981). In a relevant article, Professor Stanley Surrey comments:

> [W]e can here see the importance of distinguishing tax expenditures and tax incentives—so-called special tax provisions—from those provisions considered a proper and necessary part of the structure of an income tax. . . . It thus is necessary to the rationale of that tax to provide the deductions from gross income required to produce the net income base of the tax. Those deductions, generally speaking, are the expenses and costs incurred in the process of producing or earning the gross income received by the taxpayer.

Surrey, *Tax Incentives—Conceptual Criteria for Identification and Comparison with Direct Government Expenditures*, in TAX INCENTIVES, *supra* note 12, at 23.

In July 1990 the Bush Administration leaked its tentative thoughts on limiting the deduction of state and local income taxes to $10,000. This idea was at odds with economic theory and was not designed to further any nontax social policy, so its demise was not surprising. *See* Rosenbaum, *A Tax Debate Revived*, N.Y. Times, July 29, 1990, § 1, pt. 1, at 1, col. 5.

28. For tentative support of this assertion, see Turnier, *supra* note 27, at 274-75. A property tax could be seen as an income tax on imputed income from use of one's home, but if characterized in this way, it becomes a cost of earning tax exempt income. It should then be nondeductible under the policy of § 265 of the Code, which prohibits a deduction for expenses incurred to earn tax exempt income. I.R.C. § 265 (1989).

29. If one is searching for an economic quid pro quo for a homeowner's property tax, consider that the homeowner probably bought the home at a substantial discount from its cost in a taxless world, due to the implicit lien of the property tax obligation. So each year's property tax payment, to the extent it does not exceed the level anticipated by the market at time of purchase, resembles a payment to a third party for the value of that discount.

30. TREASURY I, *supra* note 17, vol. 2, at 63. One might defend deductibility of state and local taxes on the ground that payment is involuntary. Involuntariness, however, should not be the test of deductibility. Furthermore, an assertion that home property tax is involuntary cannot be accepted. If it were, then the performance of every binding obligation that is undertaken voluntarily becomes an involuntary act. The purchase of a home is a voluntary act, and so are all the obligations that were known to attach to that initial act.

31. My research assistant, David Miller, deserves credit for helping me to see that this voluntary-involuntary issue is a red herring.

such as state and local income taxes, are not income and, therefore, are deductible.

III. Federalism Policy Fails to Override Economic Theory

Discussions of a federal deduction for state and local tax payments frequently mention a federalism policy that favors deductibility. Federalism refers to cooperative interaction of the federal government and its law with state and local governments and their laws. The history of the creation of our country depicts an intended sharing of power between state and federal governments that is more balanced than is required by the Constitution. In attempting to follow the spirit rather than the letter of the Constitution, the federal government often exercises its broad constitutional powers in a manner deferential to the states.[32]

In taxation, this federalism policy favors a federal deduction for all state and local taxes. A legitimate concern is that deduction of some, but not all, types of state and local taxes will place an inappropriate pressure on jurisdictions that utilize nondeductible taxes. Residents of these jurisdictions will bear a heavier net tax burden than similarly situated residents of states and cities using deductible taxes. One way to eliminate such discrimination is to deny deduction of all types of state and local taxes. As a matter of sound tax policy, however, state and local income taxes must be deducted in calculating a definitionally legitimate net income.[33] They are an ordinary and necessary cost of earning income. Nondeductibility of all tax types, therefore, is not an acceptable solution. If deduction of state income tax is allowed, federalism policy favors a deduction for all types of state taxes.

At the inception of our constitutional income tax in 1913, all state and local tax payments were deductible, except improvement assessments.[34] In the Revenue Act of 1934, the deduction for state gift and inheritance tax was eliminated.[35] The Revenue Act of 1964 changed the statutory approach from one allowing deduction of all state and local taxes except those listed, to one allowing only a specific listing of deductible tax types.[36] As a result, driver's license fees, other state and local license fees, and tobacco and alcohol taxes became nondeductible. A 1972 amendment eliminated the deduction for motor vehicle sales tax to the extent that it was imposed at a higher rate than general sales tax

32. *See* Wilmarth, *The Original Purpose of the Bill of Rights: James Madison and the Founders' Search for a Workable Balance Between Federal and State Power*, 26 AM. CRIM. L. REV. 1261, 1261-64 (1989).

33. *See supra* note 27 and accompanying text.

34. *See* Tariff Act of 1913, Pub. L. No. 63-16, § II(B), 38 Stat. 114, 167.

35. Revenue Act of 1934, Puh. L. No. 73-216, § 23(c)(3), 48 Stat. 680, 688.

36. Revenue Act of 1964, Pub. L. No. 88-272, § 207(a), 78 Stat. 19, 40.

in that jurisdiction.[37] The Revenue Act of 1978 repealed the deduction for state and local motor fuel taxes.[38] Most recently, in 1986 deduction of the sales tax was eliminated.[39]

History reveals a relentless constriction of deductions for state and local taxes. Federalism policy favoring broad deductibility to avoid discrimination has been overridden so many times that it has become a hollow argument. It provides an excuse for keeping a deduction that really is being maintained for other reasons, perhaps only by political inertia.

Repeal of the sales tax deduction tolled the final bell for this federalism policy argument. Nondeductibility of local improvement assessments can be defended because they are charges for benefits received by property owners rather than taxes in the truest sense. Repeal of the gasoline tax deduction was based on a valid argument that the gasoline tax was not a true tax, but merely a convenient means of imposing a road use fee.[40] Cigarette and alcohol taxes are not deductible because their purpose is to discourage consumption of those products. A deduction would reduce the intended force of such taxes. No such explanations are available for the repeal of a sales tax deduction. Sales tax is a broad-based tax, adopted to provide large amounts of general revenue. Because four states have no general sales tax,[41] federalism concerns about discrimination among states choosing different revenue sources is strongest with respect to sales tax. In contrast, because real property taxes are used widely in every state, the discrimination argument favoring their deduction is much weaker. In its strongest case, then, the discrimination argument failed.

Another argument stemming from federalism policy could be based on the assumed inappropriateness of federal pressure exerted against a state revenue source in a more general sense, regardless of whether the pressure is discriminatory. In this view, the strength of federalism policy favoring deductibility would grow in proportion to the amount of deductible revenue raised by a particular tax. For purposes of this Article and proposal, those itemized deductions for real property tax that will be eliminated should be compared to those itemized deductions for sales tax that were eliminated in 1986.[42] Tax payments deducted as

37. Act of Oct. 27, 1972, Pub. L. No. 92-580, § 4(a), 86 Stat. 1276, 1277.

38. Revenue Act of 1978, Pub. L. No. 95-600, § 111, 92 Stat. 2763, 2777.

39. 1986 Tax Act, *supra* note 4, § 134, 100 Stat. 2085, 2116.

40. D. BRADFORD, *supra* note 7, at 80.

41. TREASURY I, *supra* note 17, vol. 2, at 68.

42. As mentioned earlier, nonhome, nonbusiness real and personal property taxes should be completely nondeductible, but those tax categories are outside the scope of this Article. *See supra* note 4.

business or investment expenses, and those not deducted because the payor does not itemize, will be unaffected by this proposal. In 1986, the last year in which sales tax was deductible, $27.9 billion of sales tax was deducted.[43] Itemized deductions for nonbusiness real property tax by taxpayers with AGIs above $200,000 totalled $1.8 billion.[44] If general pressure on state revenue sources from repeal of the sales tax deduction was within acceptable bounds, the pressure from the proposal set forth in this Article will be de minimis.

IV. Housing Policy Overrides Economic Theory

David Bradford, a tax reform commentator, has asserted that "[e]limination of the [property tax] deduction would . . . reduce the tax bias in favor of housing investment in general, and owner-occupancy in particular."[45] Despite a theoretical argument that deduction of home property tax should not be allowed in calculating taxable income, one must consider whether other social policies justify an intentional tax bias in favor of owner-occupied housing. The home property tax deduction has been authorized throughout our income tax history.[46] A paucity of legislative history leaves unclear the original reason for this deduction. In recent years, though, a social policy of encouraging home ownership frequently has been identified as the force supporting deduction. The deduction for home mortgage interest shares this motivating social policy.[47]

Numerous social benefits are believed to flow from home ownership. Homeowners move less often than renters.[48] Parents may be induced to take a greater interest in the school system. Voter turnout[49]

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43. Internal Revenue Service, U.S. Dep't of Treasury, Pub. No. 1304, Statistics of Income—1986, Individual Income Tax Returns 64 (Table 2.1) (1989).

44. *Id.* Of the referenced amount, those deductions that were for vacation or other nonhome properties will be eliminated for reasons mentioned *supra* at notes 4 and 42. Some of the home property tax deductions in the $200,000 to $250,000 AGI range still will be deductible under the phaseout provision discussed *infra* at notes 67-68 and accompanying text. Furthermore, some of the $35.3 billion of itemized, nonbusiness real property tax deductions by taxpayers *below* $200,000 AGI will be lost to this proposal's $5000 ceiling, and some will be denied by a related ohjection to deduction of property tax on vacation properties. Nevertheless, the $1.8 billion figure in the text accurately portrays the general magnitude of deductions affected by this proposal.

All itemizing taxpayers deducted $2.5 billion of personal property tax, which would he disallowed by the parallel thinking discussed *supra* at notes 4, 42, and accompanying text.

45. D. Bradford, *supra* note 7, at 79.

46. *See* Billman & Cunningham, *supra* note 16, at 1108 & n.3.

47. "[E]ncouraging home ownership is an unportant policy goal, achieved in part by providing a deduction for residential mortgage interest." S. Rep. No. 313, 99th Cong., 2d Sess. 804 (1986).

48. Squire, Wolfinger & Glass, *Residential Mobility and Voter Turnout*, 81 Am. Pol. Sci. Rev. 45, 48-49 (1987).

49. *Id.* at 52.

and other forms of local political involvement increase.[50] Owners maintain their homes better than renters and landlords, thus providing aesthetic benefits to neighbors.[51] Better maintenance of homes also supports local real estate prices, thereby likely increasing motivation of nearby owners to improve and maintain their property and motivation of lenders to finance such activities.

The least articulable social policy favoring home ownership, but certainly the most significant, is that owning one's home is a fundamental part of the "American Dream." Attaining that goal primarily benefits the individual, but a widespread perception that each individual has a good chance of attaining the goal is considered a social benefit. A high rate of home ownership helps persuade those who currently are unable to own that they have a chance to own a home.[52]

All these social benefits seem to be advanced by government programs that make it easier to own a home. Nevertheless, society suffers certain detriments from its decision to maintain owner-occupied housing above a free market level. Equity and debt capital are pulled away from more productive alternate uses, thus lowering the gross national product and raising capital costs to other sectors of the economy. A sector of production that cannot be exported is expanded—partially at the expense of other, exportable production—with negative consequences to our balance of payments. Tax deductions granted to encourage home ownership reduce aggregate taxable income, thereby requiring higher rates to achieve desired revenue, which, in turn, intensifies the distortions and other problems inevitably caused by an income tax.[53] Funds used or revenue foregone to help taxpayers move from a nice rental to a nice owned home might be used more productively to help poorer people move from a squalid rental to a tolerable rental. One might surmise that the desirability of tenants increases with their income. If so, converting middle-class tenants to homeowners decreases the percentage of "good" tenants in the rental market, reduces the general attractiveness of rental housing as an investment or a career, and increases rents for those who remain tenants. Home ownership decreases mobility of labor and increases costs of moving to a new

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50. Alford & Scoble, *Sources of Local Political Involvement*, 62 AM. POL. SCI. REV. 1192, 1197-99 (1968).

51. Galster, *Empirical Evidence on Cross-Tenure Differences in Home Maintenance and Conditions*, 59 LAND ECON. 107, 110-12 (1983).

52. Of course, one should not ignore the purely political forces behind government housing assistance. Lenders, builders, and realtors have strong self-interests in programs that keep housing supply above its free market level, and their lobbying efforts are well organized and well financed. At this point, however, the Article attempts to identify legitimate social policies behind expanded home ownership opportunities.

53. W. VICKREY, *supra* note 5, at 23-24.

job at a distant location. These negative effects receive very little attention in discussions of a social policy favoring home ownership.

In any event, positive and negative considerations have led Congress to conclude that allowing tax deductions which increase home ownership are more important than following a theoretically pure definition of income. It is important to note that such a conclusion might reflect an optimal balancing of policy considerations. This Article proceeds generally as if it does. Certainly, theoretical definitions and free market forces do not always lead to optimal results.

V. Subsidy Analysis

Only after the force behind the home property tax deduction has been identified clearly as a social policy of encouraging home ownership can the deduction be analyzed constructively. The analysis will be clearer if the "encouragement" is explicitly acknowledged and addressed as a subsidy.[54] For political reasons, this candid label often is avoided.

Subsidy analysis is neither new nor arcane. The government's goal must be precisely determined and described. A clear statement of what is not intended also may be important. An existing subsidy program then can be subjected to cost-benefit analysis by proposing changes in its terms and estimating the increase or decrease in costs and benefits from these changes. Typically, costs are measured directly in money spent or, as here, in revenue foregone, while benefits must be measured subjectively. Even though a completely objective evaluation cannot be achieved, methodical analysis can clarify the subjective benefits likely to be gained or lost by a proposed change, thereby improving the decision-making process. As Stanley Surrey said twenty years ago, "These methods are being utilized more and more to devise and test direct expenditures, and they should a priori be equally applicable to programs using a tax incentive technique."[55]

The general goal of this subsidy apparently is to increase the rate of home ownership. Qualification of high-income taxpayers for this subsidy raises two questions. The first concerns goal definition. Assuming for a moment that this subsidy will increase the rate of home ownership among high-income individuals, is such an increase a part of the gov-

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54. *Treasury I* acknowledges:

> The U.S. income tax is not used simply to raise revenue. Instead, it is used to *subsidize* a long list of economic activities through exclusions from income subject to tax, adjnstments to income, business deductions unrelated to actual expenses, deferral of tax liability, *deductions for personal consumption expenditures*, tax credits, and preferential tax rates.

Treasury I, *supra* note 17, vol. 1, at 1 (emphasis added).

55. Surrey, *supra* note 27, at 3, 14.

ernment's housing policy goal? Should it be?

High-income people financially are able to purchase homes without a subsidy. Those high-income individuals who, in absence of this subsidy, would not purchase a home likely would have based their housing decision on other factors such as a greater satisfaction from alternative consumption expenditures, a greater return on alternative investments, or a desire for mobility. The former factor is one that national housing policy might want to overcome. The latter two would produce benefits to the nation's economy and, therefore, are at odds with a subsidy that operates to convert satisfied, high-income tenants to homeowners.

A second concern about granting the subsidy to high-income taxpayers is based on cost-benefit analysis and consists of two parts. First, continue to assume that the subsidy has its intended effect in this income class. Society's benefits from home ownership[56] decrease as income rises. High-income tenants probably demand and get the same level of home exterior maintenance from their landlords as owners in the same income range obtain for their homes.[57] The neighborhoods where high-income tenants live have sufficient owner and lender support for improvements and repairs. Finally, if we have a national policy favoring a widespread perception that the American Dream is attainable, the homes of most high-income tenants will do their part to encourage middle- and low-income people to persevere.

Society's benefits from encouraging tenants to buy homes decrease with rising income, but society's costs increase. Because this subsidy is delivered through a tax deduction, its value to the taxpayer and its cost to the government increase as the recipient's income and tax rate increase. Congress has placed no limitation on the amount of the deduction. Because high-income people tend to own more expensive and, therefore, more heavily taxed homes, subsidy costs increase with income.

The foregoing analysis of granting this subsidy to high-income taxpayers focuses on the costs and benefits involved when one individual converts from renting to owning. A second cost-benefit concern involves the inefficiency of giving this subsidy to high-income taxpayers as a whole. In the process of convincing one tenant to buy a home, how much subsidy is paid to people who would have bought their homes without a subsidy? How valid is the assumption of the last several paragraphs that this subsidy increases home ownership among high-in-

56. *See supra* notes 48-51 and accompanying text.

57. Based on 1975 figures, Professor George Galster found that the most significant gap between owner-occupied and rented housing maintenance was at income levels below $11,000. Galster, *supra* note 51, at 111.

come individuals?

For people who financially are able to purchase a nice home, psychological and economic motivations to do so are very strong. The abilities to decorate and landscape a home and to stay as long as desired are attractive to most people. Ownership eliminates the risk of rent increases. Upscale homes tend to appreciate in value, often at a significant rate. Gain on the sale of a home often qualifies for a tax deferral[58] that eventually can be converted to a permanent escape from tax for up to $125,000 if sold after the owner reaches age fifty-five.[59] Subject to a generous limit, home mortgage interest is deductible.[60] Although most taxpayers probably are not familiar with the theory of imputed income from owner-occupied housing, they do know that if their home equity was placed in arm's-length investments, the profit would be taxed before it could be used to pay rent.[61] At the same time, the subsidy to tenants that was produced in the early 1980s by the highly accelerated depreciation of rental housing was eliminated by the Tax Reform Act of 1986.[62]

A subsidy achieves its goal only with those recipients who are at the margin between following or rejecting the subsidized path. Some people inevitably will receive a subsidy as a windfall because they would have taken the preferred action without a subsidy. A recipient's windfall is the government's inefficiency loss, thereby reducing benefit-cost ratio.[63] Although this type of inefficiency cannot be eliminated, a subsidy should be structured to reduce it as much as possible without causing an unacceptable reduction in total benefits.

Because of wealth or income, many taxpayers are unlikely to be at the margin of a decision between renting and owning their homes. Their access to this deduction can be limited or eliminated in several ways. Property tax attributable to home value in excess of a specified amount, perhaps $1 million, could be made nondeductible; a ceiling could be imposed on the deductible amount; or taxpayers with AGI above a specified level could be excluded from the subsidy program.

58. *See* I.R.C. § 1034 (1989).

59. *See id.* § 121. Because the unlimited exclusion of § 1014 applies to almost all assets, it is not addressed here as a home ownership preference.

60. *See id.* § 163.

61. *See id.* §§ 61 & 262.

62. *See* 1986 Tax Act, *supra* note 4, § 201(a), 100 Stat. 2085, 2121-22 (changing depreciation period for residential rental property from 19 years with an accelerated method to 27.5 years with the straight-line method).

63. Many high-income individuals may react to this housing subsidy, but only by buying a more expensive home than they would have bought without the subsidy. It is important to determine if such upgrading is part of the policy goal. *See supra* note 57 and accompanying text. It should not be. Hopefully, few congressional members would include as part of the policy goal an upgrading by high-income homeowners.

Complete exclusion of high-income taxpayers produces greater efficiency gains because such an exclusion completely denies the subsidy to the windfall class. Complete exclusion is more complicated than other proposals, though, because it requires a phaseout mechanism to avoid the inequity of granting a full deduction to those just below the cutoff and no deduction to those just above it. A ceiling, whether on home value or deduction amount, is simpler in operation, but is less efficient because it allows a substantial subsidy to the windfall class.

A $1 million value ceiling is attractive because it parallels the 1987 congressional attack on tax subsidies to luxury housing, as evidenced by the $1 million debt limit for deductible home mortgage interest.[64] That approach, however, would produce an undesirable level of uncertainty and litigation over market values. The debt limit is based on a contractually agreed and easily determined figure. A $1 million market value limit would lead to litigation over the value of almost every home with a value near the threshold. Given generally rising real estate values, any valuation case won by a taxpayer could and probably would be reinstituted by the Internal Revenue Service (IRS) within a year or two. The $1 million debt ceiling is simply a mechanism to implement the newfound policy against subsidizing luxury homes; the debt ceiling is not the policy itself. The policy can be implemented in other areas by other mechanisms.

A direct limit on the amount of deduction is appealing in its simplicity. Other than the effects of variations in property tax rates, a direct deduction limit resembles a value ceiling, yet avoids federal tax litigation over home values. A $5000 deduction ceiling and a thirty-one percent tax rate would limit the subsidy to a maximum of $1550.[65] Using the $1 million debt limit as a guide, an assumed property tax rate of twenty mills would suggest a $20,000 deduction limit. Perhaps that is as low as is currently feasible.[66] If subsidy analysis is the guide, and a definition of a windfall class of people who are very likely to own homes even without a full deduction is the goal, a $5000 limit seems more de-

64. A $1 million value ceiling also might seem more attractive than a deduction amount ceiling because it eliminates disparate income tax treatment of owners of equally valued homes that arises from differences in local property tax rates. In striving to treat equals equally, however, one first must define equals. The amount of property tax paid is more important than home value in identifying similarly situated persons for this purpose.

65. A more far-reaching proposal would change the statute from a deduction to a credit, thus allowing all taxpayers to benefit in equal proportion to their property tax burden. No sound reason supports giving more housing subsidy to one $2000 property tax payer than to another simply because the former has a higher income. My proposal, however, is motivated and guided by a view of the 1987 $1 million debt limit as a depiction of the overlap of theoretical improvement and political feasibility. This proposal works within the boundaries of that overlap area.

66. *See supra* note 2 and accompanying text, regarding inflation as an alternative to political courage.

fensible than a $20,000 limit.

The desire for even greater subsidy efficiency leads to adoption of an AGI limit on deductibility of property tax payments in addition to a deduction amount limit. AGI limits are sufficiently common that taxpayers and tax return preparers are familiar with their operation.[67] They require a phaseout mechanism over a modest income range in order to avoid a "cliff effect" that otherwise would cause taxpayers to lose the entire deduction when a one dollar increase in income pushes them past the income limit.[68]

Consider, for example, a rule denying a home property tax deduction to taxpayers with AGI greater than $250,000 and allowing a $5000 maximum deduction for those with AGI below $200,000. One percent of the deduction is denied for every $500 increase in AGI above $200,000. This AGI limit denies the subsidy to a group of people who are unlikely to be at the margin of a decision between owning and renting. Efficiency of the subsidy and benefit-cost ratio are raised, perhaps dramatically.

In 1987 approximately 388,000 taxpayers with AGI above $250,000 claimed $2.1 billion of itemized real property tax deductions, producing revenue losses of approximately $651 million.[69] It is inconceivable that more than five percent of these taxpayers would have decided to be renters if property tax were not deductible. At best, therefore, the government spent $651 million to convince 19,400 high-income people to buy homes ($34,000 per converted tenant). When high cost per recipient combines with low efficiency, the benefit-cost ratio of a subsidy program readily falls below 1:1.

Professor William Hellmuth, writing in 1977, commented:

> These tax subsidies [of bome ownership] are obviously powerful but inefficient

67. Section 67 of the Code, for example, provides that "miscellaneous itemized deductions" are deductible only to the extent they exceed 2% of AGI. I.R.C. § 67(a) (1989). In a more direct analogy to this proposed AGI mechanism, § 219 phases out the right of certain taxpayers, as their AGI increases from $40,000 to $50,000, to deduct contributions to an IRA. *Id.* § 219(g). The dependent care credit in § 21 is reduced from 30% to 20% as taxpayer AGI increases from $10,000 to $28,001. *Id.* § 21(a)(2). The opportunity to deduct up to $25,000 of certain rental real estate losses without suffering a § 469 passive loss limitation is gradually denied as AGI rises from $100,000 to $150,000. *Id.* § 469(i)(3)(A).

68. Professor Glenn Coven severely criticizes the use of phaseout provisions. *See generally* Coven, *Congress As Indian-Giver: "Phasing-Out" Tax Allowances Under the Internal Revenue Code of 1986*, 6 VA. TAX REV. 505 (1987). Obviously, I disagree with Coven's conclusion against the use of phaseouts, but his work sensitizes me to the importance of coordinating the numerous AGI phaseouts in the Code. The AGI ranges to which such provisions apply shonld be selected to assure that no taxpayer will be in more than one phaseout range at a time. In addition, the range of every AGI phaseout should be of sufficient length to produce an acceptably low surtax rate.

69. INTERNAL REVENUE SERVICE, U.S. DEP'T OF TREASUEY, PUB. NO. 304, STATISTICS OF INCOME—1987 INDIVIDUAL INCOME TAX RETURNS 49 (Table 2.1) (1990) [hereinafter STATISTICS OF INCOME]; *see infra* note 89.

and inequitable. Other federal housing programs have upper limits either on the income of the recipient, the size of the subsidized mortgages, or the value of the housing unit. There are no limits on the deductions that a homeowner may take for mortgage interest and property taxes.[70]

Although a small step in the right direction has since been taken, as evidenced by the $1 million debt limit on deductible interest, Hellmuth's unfavorable subsidy analysis of the property tax deduction remains apt.

VI. Responses to Possible Counterarguments

Several counterarguments to this proposal should be addressed. First, one must consider the complexity introduced by any proposed tax law change. Most of the 29.5 million taxpayers with AGI below $200,000 and itemized real property tax deductions[71] will be unaffected by this provision. Those with home property taxes greater than $5000 will experience only a simple ceiling. The 388,000 taxpayers with AGI greater than $250,000[72] will find their tax preparation slightly simplified by a complete elimination of the deduction. The 111,000 affected taxpayers with AGI between $200,000 and $250,000[73] will need a one-page worksheet to help calculate their partial deduction.

A second consideration is the classic objection that failure to allow deduction of a tax payment produces a tax on a tax, or double taxation. While the double taxation assertion technically is correct, the unfairness that it implies is not self-evident. Numerous taxes, both minor and major, are not deductible in calculating federal taxable income.[74] Objection to a tax on a tax is of only superficial appeal.

Fairness is one test of a tax burden distribution system. The use of several types and levels of taxes in our total tax system is immutable. Comparison, then, is between two multilevel tax systems that are identical in their components, terms, and revenues raised. One system, however, allows deductions against the upper level tax for payments to lower level jurisdictions; the other system, by not allowing these deductions, produces equal revenue with lower rates.

In shifting from the lower rate system with no integrating deductions to the higher rate system with these deductions, some taxpayers will suffer a net tax increase, while others will enjoy a decrease. If fundamental fairness requires integrating deductions, this shift inevitably

70. Hellmuth, *supra* note 6, at 195.

71. Statistics of Income, *supra* note 69, at 49 (Table 2.1).

72. *Id.* The cited table combines all taxpayers with AGI from $200,000 to $500,000; therefore, I have divided that category by linear interpolation from the categories above and below it.

73. *Id.*

74. *See supra* notes 35-39 and accompanying text.

will produce a fairer allocation of the tax burden. This increased fairness, however, is not inevitable. Consider, for example, two taxpayers who have identical income and spending patterns, except that Andy pays $20,000 in property tax, while Becky pays only $5000 in property tax on her less expensive home and gives the remaining $15,000 to charity, which is deductible. In shifting from a system that does not allow a property tax deduction to one that does, without changing total revenue, Andy's tax burden will decrease and Becky's will increase.

A third possible counterargument to this proposal is that the wide variation in property tax levels in different communities will produce unfair results. To state this objection more candidly, the federal government should maintain a subsidy program to reduce differences in property taxes borne by high-income homeowners in different communities. This unfairness, if any, is in the property tax variation, however, and not in the income tax treatment of property tax payments.[75] Differences in the types of taxes and levels of local service chosen by voters in their state and local elections account for most property tax variation.[76] The $1 million mortgage ceiling ignores a similar objection based on wide variation in housing prices. Congress's refusal to adjust standard deduction[77] and personal exemption[78] amounts for different locations rejects a similar argument based on general cost of living variations.

Another objection related to the preceding one is that the real value of a $200,000 income varies dramatically in different communities. First, as with a $1 million mortgage ceiling, a $200,000 income threshold is high enough that taxpayers of modest means will not lose their deduction. The only valid aspect of this objection is illustrated through a scenario in which a $200,000 taxpayer in Nebraska suffers only a $5000 deduction ceiling, even though that taxpayer is much richer, in real terms, than a $250,000 taxpayer in New York City who loses the entire deduction. Second, this objection and the preceding one are central to a national tax system based on nominal dollar incomes. Regional differences in dollar value simply cannot be addressed within bounds of administrative reality.

Qualitative differences between interest and property tax give rise to a counterargument regarding inequitable results in certain circum-

75. The fundamental problem underlying any thoughtful discussion of a federal deduction for home property tax is the unfairness of our property tax system as applied to homes. Because the system is so entrenched that its repair or replacement seems taboo, we struggle blindly with only the extraneous symptoms of the problem, such as the impropriety of this federal deduction.

76. For example, Oregon has no sales tax, and Washington and Wyoming have no income tax. TREASURY I, *supra* note 17, vol. 2, at 68.

77. *See* I.R.C. § 63(c) (1989).

78. *See id.* § 151.

stances. As mentioned earlier, home mortgage interest and home property tax are analogous costs.[79] One significant distinction, however, is that future interest payments are predictable and diminishing, whereas property tax costs are unpredictable in amount and usually increasing. Taxpayers with AGI above $200,000 typically can plan to pay off their home mortgages before they retire, while property tax obligations continue indefinitely, perhaps with a modest partial exemption for senior citizens. Nonetheless, the burden caused by a phaseout should be considered relative to a taxpayer's income.

With a deduction limit based on AGI and beginning at $200,000, the likelihood that a deduction phaseout will help pressure persons from their homes is minimal. A person with $200,000 AGI reasonably might buy a $500,000 home subject to a $10,000 property tax. Deduction of a maximum $5000 property tax produces a $1550 income tax saving.[80] If appreciation and a rate increase cause the property tax to triple, and if the taxpayer's AGI increases to $250,000, the $50,000 income increase will be sufficient to bear all additional taxes:

$20,000	Property tax increase
1,550	Lost income tax savings
15,500	Income tax on increase, with no property tax deduction
$37,050	

Although this is not a satisfying way to "spend" a $50,000 raise, it shows that the deduction phaseout will not force a person to move, even under extreme circumstances. If a taxpayer's income does not rise, property taxes alone could force a sale, but the federal rule would not be a contributing factor.

If this counterargument protests that a home might be lost because of federal refusal to allow a deduction, as with taxpayers who have AGI above $250,000 and those who have property tax above $5000, it simply goes too far. The deduction of utility costs sometimes might prevent the loss of a home. People who enter a subsidized transaction with knowledge that the subsidy may be withdrawn under certain rational circumstances cannot claim to be burdened unfairly when the circumstances arise and the withdrawal occurs.

An objection will be made by existing homeowners that they relied on a property tax deduction when they bought their homes. A reliance argument, in its absolute form, is no longer valid after the frequent, major changes of the 1980s. The reliance concept in this context was

79. *See supra* note 3 and accompanying text.

80. This assumes a 31% federal income tax rate. *See* I.R.C. § 1(a).

borrowed from tort law.[81] In that original setting, reliance was required to be reasonable to create a legal right.[82] Today, reliance on the permanence of any tax rule is not reasonable.

The proposal developed in this Article must be applied to all homeowners, regardless of whether they purchased their homes prior or subsequent to the proposal's adoption. Otherwise, discrimination of an unacceptable level and duration will result. In the analogous limit on home mortgage interest, the permanent grandfathering of pre-October 13, 1987 debt[83] is objectionable. A similar rule for a property tax deduction limit would be worse. First, the grandfathering rule would last as long as persons keep their homes, while the debt protection normally extends only to the expiration of an existing mortgage. A debt incurred just before the October 13, 1987 deadline would be grandfathered for its thirty-year term, but many protected mortgages had substantially less than thirty years remaining after 1987. Second, the value of a grandfather rule for interest decreases each year as principal is amortized and interest charge falls, but the value of a grandfather rule for property tax normally will increase each year as assessed value and property tax rates rise.

All that taxpayers can expect is a gradual transition to a new rule. Although permanent grandfathering of existing homeowners is not acceptable, a phase-in for them would be reasonable. One simple and equitable method would be to initiate the ceiling at $30,000 for existing owners, and then to reduce it to $5000 over a five-year period. In addition, existing homeowners could be exempted from the AGI phaseout during this five-year period.

An objection to any deduction limit using an AGI phaseout is its production of effective marginal tax rates higher than the statutory rate. Although this is an inevitable effect of an AGI phaseout mechanism, it can be kept within acceptable bounds by adjusting the length of the phaseout range. Under this proposal, the most severe case will involve a taxpayer in the phaseout range who pays $5000 or more in property tax and a thirty-one percent income tax. The phaseout mechanism will increase the taxpayer's effective marginal federal tax rate to 34.1 percent. That rate is less than the marginal rate now borne by a husband and wife who each earn $50,000 and, thus, is apparently within the current boundaries for acceptable tax rates.[84]

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81. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS, §§ 537, 552 (1977).

82. *Id.*

83. I.R.C. § 163(h)(3)(D) (1989).

84. Depending on their amount of itemized deductions, this couple probably will pay an I.R.C. § 1(a) income tax of 31% and (on earned income) a social security tax of 7.65%, I.R.C. § 3101, for a total rate of 38.65%.

An objection to this proposal may arise because the $1 million debt ceiling for deductible home mortgage interest reflects a policy of limiting federal subsidies for luxury homes, whereas this proposal focuses directly on owners' income. A high-income person can avoid the interest deduction limit by owning a less expensive home, or even by owning a very expensive home with a mortgage below the ceiling. A high-income person, however, cannot avoid this proposed property tax deduction limit by living in a modest home. Rather than simply limiting a federal subsidy of luxury housing, as the interest limit does, this proposal reflects a policy of eliminating a federal housing subsidy to high-income homeowners. There is, of course, a substantial overlap between the two affected groups. How many homeowners with AGI greater than $250,000 pay less than $5000 in home property tax? Members of that group are the only ones adversely affected by this slight change in policy focus.

Nevertheless, any high-income taxpayer who lives in a home of atypically low value will not lose a major tax saving if the deduction is denied. Subsidy analysis shows that Congress chose a crude tool when it crafted the interest deduction limit. Allowing any interest or property tax deduction to an owner of a $1 million home achieves almost no benefit for society. Congress moved in the right direction with its debt limit in 1987, but a limit based on AGI more effectively promotes the underlying goal of increasing the benefit-cost ratio of the subsidy. Further, the policy goal of preserving low statutory rates in the face of demands for more revenue is served by eliminating deductions that subsidize consumption by high-income taxpayers. If a $1 million value ceiling were imposed on property tax deductions, the new revenue generated would be insignificant and low rates would remain at risk.

A final popular basis for opposition to a tax increase rests on the argument that higher income taxes dampen saving and investment.[85] That argument is not applicable here because this proposal only imposes increased tax on consumption expenditures. That which is described as the federal income tax is actually a hybrid system composed of income tax and consumption tax elements. Income tax elements produce double taxation of savings and thereby reduce the incentive to save, leading to the economic argument described above. Consumption tax elements do not detract from the incentive to save.[86] Speaking pre-

85. In economic literature "saving" and "investment" each have a distinct definition, but unless one subscribes to economist John Maynard Keynes's theory of oversaving, the two terms can be (and commonly are) addressed jointly in discussions of the effect of taxes on saving and investment.

86. A consumption tax will lower savings a little because some people will reduce their saving to keep their after-tax level of consumption from falling. If revenue from the tax is used to reduce

cisely, this proposal reduces a consumption subsidy rather than increasing a consumption tax, but the two yield equivalent effects.

Our budget deficit drains funds from private to public sectors, thereby reducing available capital and increasing capital costs for private business. An increased tax on consumption will not lower saving significantly; therefore, if it is used to reduce the deficit, it will shift private saving back from the public to the private sector, increasing available capital and reducing capital costs for private business.

Recent talk of a national Value Added Tax (VAT)[87] is premature and hypocritical as long as the income tax system is still subsidizing consumption by high-income taxpayers. Before the federal government starts *taxing* consumption by middle- and low-income citizens, it should stop *subsidizing* consumption by the upper income citizens. Even without a VAT, a federal housing subsidy for the top 0.5 percent[88] income stratum is indefensible when a debilitating deficit continues and programs affecting education, drug abuse, the environment, and other pressing concerns remain seriously underfunded.

With every argument against this proposal, one must return to the subsidy analysis developed earlier. A housing subsidy for homeowners with income over \$200,000 is costly, the likelihood that such a recipient will choose to rent upon removal of the subsidy is low, and social benefit from occasionally shifting the recipient from tenant to owner status is small. Based on 1987 data, this proposal would reduce federal housing subsidies to high-income homeowners by approximately \$711 million, allowing that amount to be used for deficit reduction or spent on programs with greater social benefit.[89]

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an existing budget deficit, capital thereby released to the private sector will exceed this savings reduction, producing a net increase in savings available for investment in the private sector.

87. "Senator Alan K. Simpson of Wyoming, the Republican whip, said a long list of 'revenue increases' were 'in the mix,' including a national lottery and a value-added tax, a national sales tax of 1 percent. He said Mr. Bush had not endorsed or rejected any of them . . . ." Rosenthal, *Bush Budget Chief Sounds the Alarm on a Rising Deficit*, N.Y. Times, May 9, 1990, at A1, col. 6.

"The cornerstone of my own deficit-reduction plan is a broad-based consumption levy—a value-added tax—modeled on the VATs that have proven so successful in the European Community and across the Pacific Rim." Senator Ernest Hollings, *A Way Out of the Budget Quagmire*, Wash. Post, Sept. 4, 1990, at A19, col. 1.

88. STATISTICS OF INCOME, *supra* note 69, at 20 (Table 1.1).

89. *Id.* The United States Treasury's *Statistics of Income* shows returns claiming itemized deductions, categorized by AGI. Unfortunately, because returns with AGI from \$200,000 to \$500,000 constitute a single category, the \$200,000 to \$250,000 phaseout range used in this proposal cannot be analyzed with certainty. By linear interpolation from the data table relating AGI to real estate tax deductions, it is estimated that taxpayers in the \$200,000 to \$225,000 range deducted \$202 million. Coupled with assumptions that they all would be in today's 31% bracket and would lose an average of 25% of their deductions to the phaseout, this group produces an estimated \$16 million in additional revenue. Taxpayers in the \$225,000 to \$250,000 range deducted an estimated \$191 million. They were assumed to be in today's 31% bracket and experiencing a 75%

VII. Conclusion

This Article argues that an economic definition of net income does not allow an income tax deduction for home property tax payments, but that strong social policies might justify the deduction. Federalism concerns, which are commonly proposed as a justifying social policy, are reviewed and rejected. A second policy, society's desire for an enhanced rate of home ownership, is considered and accepted as a legitimate justification for a deduction. Closer scrutiny of that social policy, however, reveals that it does not justify the unlimited deduction allowed by current income tax law. Significant restrictions on the deduction can be imposed to reduce its cost in lost income tax revenues, yet still allow it to promote the goal of high home ownership levels.

This general approach could be applied to all itemized deductions for personal consumption expenditures in an effort to improve the fairness of and revenue from our income tax without increasing tax rates. Those who consider today's historically low rates valuable for economic growth, as I do, should search for ways to remove wasteful subsidies from camouflaged positions in the Internal Revenue Code.

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phaseout, producing revenue of $44 million. Taxpayers with AGI above $250,000 deducted $2.1 billion. Assuming a 31% tax rate, this group will produce $651 million additional revenue, for a total revenue gain from these groups of approximately $711 million.

The revenue effect of the $5000 ceiling is not estimated here, but probably will be modest. Its main value in the short run is to minimize the de facto surtax effect of a phaseout mechanism, as described *supra* at note 84 and accompanying text. Revenue effects for 1991, of course, would be substantially larger.

For comparison purposes, when the 1987 Tax Act was in Congress, the adoption of the $1 million debt ceiling was estimated to generate $54 million of additional revenue in 1990. H.R. Conf. Rep. No. 495, 100th Cong., 1st Sess. 1024 (1987).